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No. 858

In the Supreme Court of the United States

OCTOBER TERM, 1959

RAYMOND J. FUNKHOUSER, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 8–17) [1] are not officially reported. The opinion of the court of appeals (Pet. 17–26) is reported at 275 F. 2d 245.

JURISDICTION

The judgment of the court of appeals was entered January 14, 1960 (Pet. 17). The petition for a writ of certiorari was filed on April 12, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

The taxpayer-donor made gifts in 1948 and subsequent years to seventeen trusts under each of which

[1] Record references are to the appendix to the taxpayer's brief in the court of appeals.

the trustees were required to distribute the trust income annually to the beneficiary and had full discretion to distribute all or a part of the corpus at any time to provide for any illness or emergency or for the care, maintenance, support or education of the income beneficiary or of any member of the beneficiary's immediate family. The question is whether the court below erred in holding that for gift tax purposes the income interests of the beneficiaries could not be valued because of the trustees' power to disburse trust corpus and, accordingly, that the taxpayer-donor is not entitled to exclusions for gifts of present interests under Section 1003(b)(3) of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

> SEC. 1003. NET GIFTS.
>
> (a) *General Definition.*—The term "net gifts" means the total amount of gifts made during the calendar year, less the deductions provided in section 1004.
>
> (b) *Exclusions from Gifts.*
>
> * * * * *
>
> (3) [as added by Sec. 454 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Gifts after 1942.*—In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1943 and subsequent calendar years, the first $3,000 of such gifts to such person shall not, for the purposes of subsection (a), be included in the total amount of gifts made during such year.

(26 U.S.C. (1952 ed.) 1003)

Treasury Regulations 108, promulgated under the Internal Revenue Code of 1939:

> Sec. 86.10 *Total Amount of Gifts.*—Except with respect to any gift of a future interest in property, the first $3,000 of gifts made to any one donee during the calendar year 1943 or during any calendar year thereafter shall be excluded in determining the total amount of gifts for such calendar year. In the case of a gift in trust, the beneficiary of the trust is the donee of the gift. * * * The entire value of any gift of a future interest in property, * * * must be included in the total amount of gifts for the calendar year in which such a gift is made.
>
> Sec. 86.11 [as amended by T.D. 5902, 1952–1 Cum. Bull. 167] *Future Interests in Property.*—No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the calendar year. "Future interests" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time. The term has no reference to such contractual rights as exist in a bond, note (though bearing no interest until maturity), or in a policy of life insurance, the obligations of which are to be discharged by payment in the future. But a future interest or interests in such contractual obligations may be created by the limitations contained in a

trust or other instrument of transfer employed in effecting a gift. For the valuation of future interests, see section 86.19(f) or 86.19(g), whichever is applicable.

STATEMENT

The taxpayer created seventeen separate trusts for his five children and twelve grandchildren between 1948 and 1953, to which he gave shares of stock of Victor Products Corporation and Funkhouser Industries, Inc. (R. 9–10). All of the Funkhouser trusts are irrevocable. They are to terminate twenty-one years after the death of the survivor of the donor's children or, if said death shall occur prior thereto, upon the death of the last surviving descendant of the donor. Upon termination, the trust fund as then constituted is to be paid and distributed to the persons who were entitled to receive trust income immediately prior to the termination of the trust. The fifth article of each trust provides that during the term of the trust the trustees are to pay all of the net income each year to the primary and initial beneficiary during his or her life and, after the death of such beneficiary, to his or her descendants, if any, or, if none, then to other designated beneficiaries (Pet. 18–19; R. 10–11). Paragraph 3 of the fifth article provides (Pet. 19; R. 11):

> 3. Notwithstanding anything herein to the contrary provided, the Trustees are authorized in their absolute discretion from time to time to pay over or to expend on behalf of any person who is an income recipient hereunder at the time, such sum or sums from the principal

> of the Trust as they shall deem necessary or advisable to provide for any illness or any emergency affecting such person who is an income recipient hereunder at the time or any member of his or her immediate family, or to provide for the care, maintenance, support or education of such person or any member of his or her immediate family.

The taxpayer-donor claimed a total of sixty-four exclusions for gifts of present interests in his gift tax returns for 1948 and 1950 through 1953. The Commissioner determined that no exclusions were allowable because the gifts were of future, rather than present, interests within the meaning of Section 1003(b) of the Internal Revenue Code of 1939[2] (R. 12–13).

The Tax Court upheld the Commissioner's deficiency determinations, holding that the gifts of a present right to receive trust income could not be valued for gift tax purposes because of the trustees' discretion to disburse the corpus and that, therefore, the taxpayer-donor is not entitled to exclusions for gifts of present interests under Section 1003(b)(3) of the Internal Revenue Code of 1939 (R. 14–17). The court of appeals affirmed (Pet. 17–26).

ARGUMENT

The decision below is correct and is in accord with the decisions of four other circuits which previously determined the same basic issue. There is thus no

[2] The trusts and trustees are parties only because transferee liability was asserted against them (R. 14). In the court below, transferee liability was conceded in the event the decision of the Tax Court was sustained.

conflict of decisions or other reason warranting further review by this Court.

1. Section 1003(b)(3) of the Internal Revenue Code of 1939 (*supra*, p. 3) authorizes the exclusion of the first $3,000 of each gift to another person in a calendar year in determining the amount of net gifts (see Section 1003(a), *supra*, p. 3) on which gift tax is imposed by Section 1001 (26 U.S.C. (1952 ed.) 1001), provided the gift is not of a future interest—that is, an interest which is limited to commence in use, possession, or enjoyment at some future time. *Commissioner* v. *Disston*, 325 U.S. 442; *Fondren* v. *Commissioner*, 324 U.S. 18; see also *Ryerson* v. *United States*, 312 U.S. 405; *United States* v. *Pelzer*, 312 U.S. 399; *Helvering* v. *Hutchings*, 312 U.S. 393. For the statutory exclusion to be applicable, "[t]he taxpayer claiming the exclusion must assume the burden of showing that the *value* of what he claims is other than a future interest" (emphasis added). *Commissioner* v. *Disston*, *supra*, 325 U.S. at 449; see also Rev. Rul. 54–92, 1954–1 Cum. Bull. 207.

In the present case it is conceded that the interests of the beneficiaries in trust corpus are future interests (Pet. 10, 20). On the other hand, the beneficiaries' present rights to receive trust income are present interests for which exclusions are allowable if the interests are such that they can be valued. The income interests of the beneficiaries, however, are interests attaching to trust corpus which can be reduced and even wiped out by exercise of the trustees' discretion to disburse corpus. Since the beneficiaries had no interest in the income from any ascertainable

amount of corpus, it is apparent, and conceded by the taxpayer, that the present income interest could not be valued separate and apart from the future interests.

The taxpayer contends (Pet. 12–13, 14–15), nevertheless, that the income interests should be valued as life estates on the theory that exercise of the trustees' discretion would only result in increasing, rather than decreasing, the beneficiaries' interests. This approach disregards the fact, first of all, that trust corpus could be distributed by the trustees not just for an income beneficiary's benefit but for the benefit of any member of his or her immediate family. It is not necessarily true, therefore, that the income beneficiary's interest could only be increased by exercise of the trustee's discretion. Aside from that, the taxpayer's approach assumes that a portion of the value of the future interests (*i.e.*, the corpus) may be attributed to the present income interests to support valuation of the latter. This assumption is directly contrary to the well-established rule that no exclusion is allowable in respect of any part of the value of future interests.

2. Even prior to the decision below, the position taken by this taxpayer had already been consistently rejected by the courts. The Third, Fifth, Eighth, and Tenth Circuits had all held that the possibility of reduction or destruction of trust principal, even if solely for the benefit of the income beneficiary, renders impossible any ascertainment of the present worth of a gift of trust income and therefore precludes allowance of the statutory exclusion. *La Fortune* v. *Commissioner*, 263 F. 2d 186 (C.A. 10); *Herrmann's*

Estate v. *Commissioner*, 235 F. 2d 440 (C.A. 5); *Evans* v. *Commissioner*, 198 F. 2d 435 (C.A. 3); *Kniep* v. *Commissioner*, 172 F. 2d 755 (C.A. 8); see also *Brody* v. *Commissioner*, 19 T.C. 126. If this established rule seems "illogical," as the taxpayer asserts (Pet. 13), it is because Congress chose to draw a line between the value of gifts of future interests and of present interests.

The taxpayer is in error in asserting (Pet. 11–12) that the decision below is in conflict with this Court's decisions in *Helvering* v. *Hutchings*, 312 U.S. 393, and *United States* v. *Pelzer*, 312 U.S. 399. The sole holding in the *Hutchings* case was that, in the case of a transfer of property for the benefit of numerous beneficiaries, the statute allows an exclusion for the gift to each beneficiary rather than but one exclusion for a gift in trust, assuming that the gifts are not of future interests. In the *Pelzer* case, this Court made a similar holding and, in addition, concluded that under one of the trusts the gifts were of future, rather than present, interests. These decisions also state that the gift tax provisions are not concerned with the mere transfer of legal title (*Hutchings*) or with local law definitions of future interests (*Pelzer*), but those principles are not in any way involved in the present case.

Contrary to the taxpayer's assumption (Pet. 11–12, 14), the decision below does not rest on a distinction between equitable and legal ownership of property. The court below held that the income interest could not be valued because (1) the corpus of each trust could be reduced or eliminated through distribution for the benefit

of not only the income beneficiary but any member of his or her immediate family and (2), while a distribution for the benefit of the income beneficiary would increase his entire interest, the distribution would come from the corpus, which was admittedly a future interest and would reduce the present income interest (Pet. 21).[3]

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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[3] The Tax Court decisions cited by the taxpayer (Pet. 12–13) as being in conflict with the decision below are also distinguishable from the present case. *Estate of Nettleton* v. *Commissioner*, 4 T.C. 987, involved the valuation of a transfer in trust in an estate tax, not a gift tax, context and presented no problem in relation to distinguishing between the value of present and future interests. *Newlin* v. *Commissioner*, 31 T.C. 451, which was decided only a little more than a month before the Tax Court decision here, is somewhat similar to the present case but is distinguishable because the income interests of the beneficiaries were terminable only with the consent of the trustees and all living beneficiaries. Thus, each beneficiary had what amounted to a right to veto a proposed termination.

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